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SUBJECT: NORWAY'S ENERGY PART I: ROUGH WATERS AHEAD FOR
STATOILHYDRO

1.(U) Summary: In this three part series, we look at Norway's energy sector. Norway is the world's fifth largest oil exporter and the third largest gas exporter. StatoilHydro, the new Norwegian national energy champion, is a Fortune 50 company with worldwide production and export of oil and gas resources. StatoilHydro finished 2007 in a burst of optimism, completing the merger of Statoil and Norsk Hydro in October of 2007 with remarkable speed, riding a wave of high oil prices, and winning a 24% share in the Shtockman gas field. However, 2008 is off to a rough beginning for the new company, with declining projections of oil production, problems with their prestige LNG project, Snohvit, and pressure from the new Environment Minister, all while smoothing out the wrinkles of the merger and appointing new leadership. End Summary

Oil Shifting to Gas

2.(U) Norway's energy sector is transitioning from oil to gas, as oil production on the Norwegian continental shelf continues to fall. No major oil fields have been discovered in the past ten years and recently revised estimates indicate that oil production will soon begin its long-expected decline sooner and sharper than previously predicted. StatoilHydro is no exception to this trend and has adapted a multifaceted strategy to adapt, including investments abroad (in Canadian oil sands, Gulf of Mexico, Africa etc), shifting to gas production, including LNG, and pushing for looser environmental restrictions in the remaining areas in Norway which have been closed to exploration. All of these strategies have promise but so far 2008 has highlighted the problems inherent in each.

International Investments Putting StatoilHydro on the Environmental Blacklist?

3.(U) StatoilHydro has investments in 31 nations including difficult countries such as Iran, Venezuela and Libya. Corruption has been a problem for the company in some countries, most forcibly demonstrated by the forced resignation of former Norsk Hydr boss Eivind Reitan (previously slated to take over as chairman of StatoilHydro) over a bribery scandal in Libya. These issues are common to most international energy companies but StatoilHydro faces the additional challenge of maintaining an environmentally friendly image.

4.(SBU) Events in late 2007 and early 2008 have forced StatoilHydro to defend its environmental commitment to both public and governmental critics. Public concern over an oil leak from a subsea pipe late in 2007 (caused by a ship's anchor) foreshadowed the criticism facing the company in early 2008. Environmental Minister Erik Solheim (also Development Minister and an influential member of Government) recently attacked StatoilHydro for investing in the environmentally damaging Canadian oil sands and for lobbying the government to open previously closed environmentally sensitive areas of the Norwegian Continental Shelf for exploration. Solheim expressed surprise and concern that the majority state-owned company was pushing the government to adapt environmentally unfriendly policies and was investing in environmentally harmful projects. StatoilHydro CEO Helge Lund reacted strongly to this criticism saying that it was the company's & democratic right to express its opinions and that he could not accept Solheim's attempt to silence the company. Oil and Energy Minister Aslaug Haga supported Lund but denied that there was disagreement in the government. Comment: Solheim's citing of state ownership was interesting given the GON's regular claim that the GON does not interfere in state-owned companies decisions, for example when pressed to end StatoilHydro's investment in Iran.

Fairest of them all? Questions about Snow White

5.(U) Expected to be StatoilHydro's flagship project for the next generation, the LNG plant Snohvit (Norwegian for Snow White) located in Hammerfest, has run into severe problems since operations began in August. The brand new facility will only reach a maximum of 60% of expected productivity in

2008 due to problems with a cooling tower that may need to be redesigned and rebuilt. This comes after a delay of one year in construction, a 50% increase in cost and a two month closure in December and January due to salt water leakage in the plant's piping. In addition the projected CO₂ emissions from the plant are much higher than expected, further tarnishing the company's environmental credentials (and damaging the GON's plans to become carbon neutral). CEO Helge Lund was recently forced to admit that he did not know the reason for the delays in getting Snohvit fully online, earning him the derisive media nickname, "Mr. Know Nothing". One bit of good news is that the first shipment of LNG from Snohvit to the U.S. (to Cove Point, MD) was delivered on February 21.

New Leadership and the Outlook for the Future

16. (SBU) Despite these challenges StatoilHydro's leadership remains optimistic. In a talk January 9 with London financiers StatoilHydro's CEO Helge Lund acknowledged problems with production but pointed to greater than expected synergies from the merger (savings of over \$1 billion per year), the promise of new areas of long-term growth (Gulf of Mexico, Canada oil sands and most importantly Shtockman) and actual growth in international production as good news. Certainly if StatoilHydro is able to book the Shtockman field reserves it will help offset some of the setbacks. However it is still unclear what price StatoilHydro paid for its stake in Shtockman or when the project could be expected to move forward. Lund along with newly appointed Chairman Svein Rennemo (previously CEO of Geo-Services ASA) have their share of challenges for the coming year. How the company performs and how the GON interacts on controversial issues will be a strong indicator of both the viability of the company and the GON's policy towards state-owned companies. Early signs are not promising with the latest corporate quarterly earnings report indicating falling earnings despite a sharp increase in energy production (which company execs attribute to increased operating/development costs).

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